In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1201

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

NATIONAL SECURITIES, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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1. The respondents attempt to belittle the importance of the question presented by asserting that this is the only case in which "any McCarran-merger problem has ever arisen" (Br. in Opp. 10). We describe in the footnote several pending insurance-company-merger cases under the antifraud provisions of the Securities Exchange Act of 1934 in which the effect of the McCarran-Ferguson Act has been raised.[1] The

[1] In *Mann* v. *Kuhn* (S.D. Ind., No. IP 64-6-455), the complaint (filed July 2, 1964, before the present case was instituted) alleged that policyholders' approval of a merger of insurance companies was solicited by false and misleading statements and omissions in violation of Section 10(b) of the Secu-

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relative paucity of litigation on this issue, however, does not indicate that the question is unimportant. Rather, it reflects the fact that prior to the present case it generally was believed that McCarran-Ferguson did not create any immunity from the antifraud provisions of the federal securities acts for the purchase and sale of insurance company securities (see our petition, pp. 11–12, 17–18). The present decision is "indisputably unique" (Br. in Opp. 10) only in the sense that it marks the first time that an appellate court has construed the McCarran-Ferguson Act as

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rities Exchange Act of 1934 and Rule 10b-5 thereunder. In moving for dismissal and summary judgment, the defendants argued that the McCarran-Ferguson Act "was intended to foreclose all federal statutes which might interfere with state regulatory programs" (brief filed November 6, 1964, p. 22). In a reply brief filed on March 18, 1966, the defendants relied upon the district court's decision in the present case (p. 22). Decision is pending.

In two cases seeking to enjoin the combination of two other insurance companies, the defendants relied upon the decision of the court of appeals in the present case. *Sample* v. *National Western Life Insurance Co.* (E.D. Mo., No. 67 C 423(3)); *Kunin* v. *Lewis* (E.D. Mo., No. 67 C 296(3)). In *Kunin* the court on January 3, 1968, denied a motion to dismiss; in *Sample* the court on January 8, 1968, entered a preliminary injunction against voting on the proposed combination.

See, also, the pending administrative proceeding before the Commission in *Pacific Insurance Company of New York and Bankers and Shippers Insurance Company of New York* (Administrative Proceeding File No. 3-982), in which applicants, in seeking an exemption from Section 17(a) of the Investment Company Act of 1940 for a non-merger transaction, argued that since the McCarran-Ferguson Act "reserves the regulation of insurance companies * * * to state law," the transaction should not be "subjected to regulation under the Investment Company Act of 1940" (applicants' brief before the Commission, pp. 43, 44).

stripping investors in insurance company securities of the protections against fraud that investors generally have under the federal securities laws. If the decision is permitted to stand, it will almost certainly lead to a substantial erosion of those protections for a significant class of investors.

2. The respondents further assert (Br. in Opp. 10) that the question "cannot arise in the future" because "the relevant Act of Congress has been materially changed since this controversy." But there has been no change in the statute under which the Commission proceeded in this case—Section 10(b) of the Securities Exchange Act of 1934, the antifraud provision. The change to which respondents refer involved Section 14 of the Act, which governs the solicitation of corporate proxies. The changes in the latter section neither lessened the importance of the Commission's authority under Section 10(b) to deal with fraud in the purchase and sale of insurance company securities,[2] nor reflected any congressional intent to leave the control of such fraud solely to State regulatory authorities.

a. Prior to 1964, Section 14 applied only to the solicitation of proxies for securities listed on a registered securities exchange. In 1964 Congress amended the Securities Act of 1934 to extend the coverage of the proxy provisions (as well as of certain other provisions) to securities of unlisted companies having assets of $1,000,000 and more than 500 shareholders. 78

[2] As noted in our petition (p. 10, n. 6), the Commission consistently has treated securities transactions involved in a merger as a purchase and sale, and two courts of appeals recently have so held.

Stat. 567. The amendments except from such extended coverage, however, securities of insurance companies that are, *inter alia*, subject to specified regulation under State law that "conforms to that prescribed by the National Association of Insurance Commissioners."[3] Following the 1964 amendments, most States adopted proxy regulations for insurance companies that met the Association's requirements.

Although such State regulatory provisions may be broad enough to cover fraud in connection with the solicitation of proxies for insurance company mergers, there is no assurance that the State authorities will apply the same comprehensive standards of fraud that have been developed under the federal securities acts, or will be able to give investors the same broad protection that the Securities and Exchange Commission can provide with its substantial staff and vast experience over many years in dealing with this frequently complex field. Indeed, in this very case the State insurance commissioner approved the merger under a statute which prohibits "untrue, deceptive or misleading" statements "with respect to the business of insurance,"[4] even though the Commission had submitted to him "all of the pleadings and evidentiary materials before the Federal District Court" (Br. in Opp. 4), which alleged that seriously false and misleading information was being used in soliciting stock-

[3] Securities Exchange Act, Section 12(g)(2)(G)(ii), 15 U.S.C. 78*l*(g)(2)(G)(ii).

[4] Arizona Revised Statutes §§ 20-444A, quoted Br. in Opp. 18.

holder consents to the merger. Moreover, as shown in our petition (pp. 16–18), the rationale of the court of appeals is not limited to fraud committed in soliciting proxies for securities transactions in connection with insurance company mergers, but would cover all violations of the antifraud provisions involving insurance company securities. These provisions, of course, are not limited to proxy solicitations but comprehend all fraud committed in the purchase or sale of securities, and the jurisdiction of the State regulatory authorities over proxy solicitations would not provide any protection in this broader area for insurance company investors.

Finally, the courts have held that violations of Section 10(b) give rise to private causes of action.[5] There is no assurance, however, that the courts of all the States will similarly recognize private remedies with respect to violations of the insurance commissioners' regulations. *Cf. J. I. Case Co.* v. *Borak*, 377 U.S. 426, 434–435.

b. The 1964 Securities Act Amendments, like the McCarran-Ferguson Act itself, did not curtail the application of the antifraud provisions of the federal securities acts to the purchase or sale of insurance company securities. Prior to the Amendments, as shown in our petition (pp. 11–12), it was regarded as settled that the antifraud provisions, which apply alike to listed and unlisted securities, covered insurance com-

[5] See, *e.g.*, *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627 (C.A. 2); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5); *cf. J. I. Case Co.* v. *Borak*, 377 U.S. 426.

pany securities. In the 1964 Amendments Congress in no way narrowed the scope of the Securities Exchange Act of 1934, or transferred to the States any of the functions previously performed by the Commission. On the contrary, Congress extended other provisions of the Act to cover some unlisted securities, but excepted from this extension of coverage securities of insurance companies subject to comparable regulation by the States. As far as those securities were concerned, therefore, the reach of the Securities Exchange Act of 1934 was no narrower after the 1964 Amendments than it had been before.

The respondent's contention thus blurs the distinction between the antifraud provisions of Section 10(b) and the recently amended proxy provisions of Section 14. Section 10(b) is directed against fraud in connection with the purchase or sale of securities, whether or not such fraud involves a proxy solicitation. Section 14 applies to all proxy solicitations (not exempted), whether or not they are related to any purchase, sale or exchange of securities. Because proxies are utilized in connection with many managerial activities of a company—activities that might be considered a part of "the business of insurance" as the term was used in the McCarran-Ferguson Act (Pet. 11–15)—there is no inconsistency between Congress' granting of the insurance exemption from the extension of general proxy regulations in 1964 and the continuation of the Commission's long-standing authority under Section 10(b) to protect all investors

against all forms of fraud in the specific area of purchases and sales of securities.[6]

Respectfully submitted.

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APRIL 1968.

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[6] There is also no inconsistency between the Commission's position in the present case and the fact that in 1964 the Commission listed "mergers" as among the examples of inadequate proxy controls over insurance companies (Br. in Opp. 12). Even though the antifraud provisions of Section 10(b) confer a jurisdiction that is in many respects broader than mere jurisdiction to regulate proxy solicitations, proxy regulation can supplement the § 10(b) jurisdiction in at least two ways: by conferring more definite authority to require affirmative disclosures in certain situations, and by providing a means of regulating mergers that may be consummated in the form of a purchase of assets without any exchange of securities.

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